

FEDERAL COURT UPHOLDS FERC'S APPROACH ON LNG ENVIRONMENTAL PERMITTING AND SHIFTS FOCUS TO CHALLENGES TO DOE'S ENVIRONMENTAL REVIEW

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On June 28, 2016, the U.S. Court of Appeals for the District of Columbia Circuit issued two opinions^[1] that uphold the Federal Energy Regulatory Commission's ("FERC") approach to reviewing environmental impacts of liquefied natural gas ("LNG") export projects. These opinions are of critical importance for developers and their financing partners alike, resolving key regulatory questions facing LNG projects. In addition, these decisions will impact pending and future appeals of interstate natural gas pipeline expansion projects also facing similar arguments from environmental opponents.

Uncertainty and regulatory risks remain, however. As outlined below, project developers, LNG offtake customers and investors need to watch legal challenges still pending that may affect LNG project permitting. In particular, the opinions shift the focus from FERC's environmental reviews of LNG export facilities to the U.S. Department of Energy's ("DOE") consideration of potential environmental impacts of long-term LNG commodity exports.

BACKGROUND

Both of the opinions address whether FERC met its responsibilities under the National Energy Policy Act ("NEPA"). NEPA requires that federal agencies consider the impacts of "major Federal actions significantly affecting the quality of the human environment."^[2] Under Section 3 of the federal Natural Gas Act, and as delegated by DOE, FERC serves as the lead permitting agency for facilities that import or export natural gas by waterborne vessels.^[3]

As the lead agency, FERC compiles the federal environmental review document mandated under NEPA. To comply with NEPA's requirements, FERC issued an environmental assessment for the Sabine Pass project and a more searching environmental impact statement for the Freeport project. Both documents took the same approach to potential environmental impacts from upstream natural gas production and downstream natural gas combustion or other final disposition of the gas. FERC determined that under NEPA, federal environmental regulations, and judicial precedent, such potential upstream or downstream impacts were not causally related to the siting, construction, or operation of the facilities, nor were they "reasonably foreseeable." As a result, the agency declined to consider these issues in-depth as part of its NEPA review.

A group of environmental associations challenged FERC's approvals of these projects alleging that FERC did not meet its obligations under NEPA and arguing primarily that:

1. FERC should have conducted an in-depth analysis of any additional natural gas production that the LNG export facilities might “induce” as an “indirect impact” of the LNG export projects
2. FERC should have considered the potential for increased natural gas exports to raise natural gas prices, triggering increased coal use and thereby increasing emissions; and
3. FERC should have considered all recently permitted LNG export projects, and their potential environmental impacts, together as “cumulative impacts.”

COURT ACCEPTS FERC'S NEPA APPROACH AND UPHOLDS FERC'S APPROVALS OF THE FREEPORT AND SABINE PASS APPLICATIONS

In two unanimous opinions, issued by a panel of two Democratic and one Republican appointees after hearing very lengthy oral argument, the court upheld FERC's approvals of Freeport and Sabine Pass's respective applications to site, construct, and operate LNG export facilities. The *Freeport* Opinion, written by Judge Millett, is the lead opinion and *Sabine Pass* adds only a few points on the merits. In *Freeport*, the court began by recognizing the court's obligation to assure that the NEPA analysis was “fully informed and well considered,” and not to “flyspeck” the NEPA analysis for any minor deficiency.^[4] Reviewing courts require that an agency take a “hard look” at the environmental consequences of the agency's actions, but NEPA does not mandate any particular outcome, and the standard of review remains deferential.^[5]

NEPA Does Not Demand that FERC Consider Alleged “Induced” Production as Indirect Effects of LNG Export Facilities

The court first rejected the claim that FERC should have considered the potential environmental impacts that an LNG export facility may have by “inducing” additional natural gas production as “indirect effects” of the agency's approval of the LNG projects.

Relying on U.S. Supreme Court precedent that “indirect effects” are “later in time or farther removed in distance” yet “reasonably foreseeable,”^[6] the court noted that a mere “but for” causal relationship was not sufficient to require an agency to review in-depth every potential effect that a facility might have.^[7] Instead, the court held that the agency can restrict its review to effects that are sufficiently likely to occur and that a person of ordinary prudence would take into account.^[8] The court found that FERC had reasonably explained that the connection Sierra Club and the other environmental petitioners suggest between FERC's authorization of LNG facilities and natural gas production is “too attenuated” to be weighed in this particular NEPA analysis.^[9]

The court noted that the record contained no evidence that the projects themselves, apart from an LNG commodity export authorization, would induce new production.^[10] The petitioners in fact could not point to a particular shale play or production region that would serve as the source of feed gas for the LNG projects.^[11]

DOE's Authority Over the Export of LNG and Natural Gas Breaks the Causal Chain and Limits FERC's Authority Obligation to Consider Over Upstream or Downstream Impacts

The court further held that any indirect effects from the export of the LNG (or natural gas) commodity were beyond the analysis that NEPA requires FERC undertake. The court emphasized and relied on the fact that the LNG commodity export authorization is within DOE's jurisdiction, and is not part of FERC's approval of the facilities used for exports.^[12] The court then concluded that when an agency does not have the ability to prevent

a certain effect due to its lack of jurisdiction over the actions that cause it, it is not responsible for assessing that effect under NEPA.^[13] The court therefore determined that FERC's orders are "not the legally relevant cause of the indirect effects Sierra Club raises,"^[14] namely, alleged potential impacts from upstream production, including hydraulic fracturing, resulting from exports.

Specifically, the court held that DOE's independent authority over natural gas exports serves as an "intervening action" that breaks the causal chain between FERC's approval of LNG export facilities and any alleged upstream impacts associated with natural gas production. The court distinguished an earlier case from another circuit in which the agency had been required to consider the potential environmental impacts of permitting new railroad lines that would allow access to 100 million tons of coal, including the potential impacts of combusting the coal.^[15] That case was "nothing like" FERC's review of the LNG export projects because DOE's intervening authority limited FERC's ability to affect any indirect consequences of exporting natural gas.^[16]

NEPA Does Not Require a Nationwide Review of All LNG Export Projects

The court also disagreed with the petitioners' arguments that FERC should consider all recently permitted LNG export projects to be "cumulative impacts" required to be assessed in a single project's NEPA review. The argument "draws the NEPA circle too wide," and the proper scope of a cumulative impacts analysis is limited to projects in the "same geographic area" as the project under review.^[17] FERC's review of the 1,600 square mile area around the Freeport facility satisfied this obligation. As to Sabine Pass, the issue had not been properly preserved and thus could not be raised on appeal.^[18]

IMPLICATIONS

By affirming that FERC complied with its NEPA obligations, the court resolved a regulatory question that has clouded the outlook for many LNG export projects nationwide. Although the court emphasized in several places that the holdings were fact-driven and therefore specific to these cases, the ruling's approach to indirect impacts, FERC's inability to regulate the export of LNG, and whether FERC had to undertake a nationwide review of LNG export projects under the guise of "cumulative impacts" should apply to most, if not all, of FERC's reviews of LNG export project applications.

However, what the court did not decide is significant too -- particularly as to DOE's LNG export authorizations. At least two DOE LNG export authorizations face pending challenges in the court of appeals, raising many of the same arguments advanced in these FERC-focused cases. The *Freeport* and *Sabine Pass* cases leave the decision of those matters to these pending cases challenging the DOE non-free trade agreement authorizations directly, in which DOE reached the same conclusions in its environmental consideration as FERC did. The court's robust conclusions as to causality in *Freeport* and *Sabine Pass* would suggest affirmance of the agency in those cases as well, but the cases remain to be decided. The first of these, also involving the Freeport project, is in the late stages of briefing, will likely be argued in the fall, and could be decided by the end of 2016. Participants in the LNG industry should monitor these and any future challenges carefully as they will play a crucial role in deciding the fate of U.S. LNG exports.

Notes:

^[1] *Sierra Club v. FERC*, No. 14-1275 (D.C. Cir. June 28, 2016) (Sierra Club's challenge to FERC's approval of the Freeport LNG export project) (hereinafter the "*Freeport* Opinion"); *Sierra Club v. FERC*, No. 14-1249 (D.C.

Cir. June 28, 2016) (Sierra Club's challenge to FERC's approval of Sabine Pass LNG's application to increase its authorized LNG export capacity) (hereinafter the "Sabine Pass Opinion").

[2] 42 U.S.C. § 4332(C).

[3] 15 U.S.C. § 717b(e).

[4] *Freeport* Opinion at 15.

[5] *Sabine Pass* Opinion at 12-13.

[6] *Id.* at 14 (citing *Dep't of Transp. v. Public Citizen*, 541 U.S. 752, 764 (2004)).

[7] *Freeport* Opinion at 16.

[8] *Id.* (internal citations omitted).

[9] *Id.*

[10] *Freeport* Opinion at 17.

[11] *Id.*

[12] See *Sabine Pass* Opinion at 13 ("What Sierra Club challenges here is the potential environmental effects flowing from greater natural gas *exports* from the Terminal") (emphasis in original).

[13] *Freeport* Opinion at 16.

[14] *Sabine Pass* Opinion at 14.

[15] *Freeport* Opinion at 18 (citing *Mid States Coalition for Progress v. Surface Transportation Board*, 345 F.3d 520, 548 (8th Cir. 2003)).

[16] *Id.*

[17] *Freeport* Opinion at 22.

[18] *Sabine Pass* Opinion at 15.

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